Supreme Court, U.S.
FILED
OCT 28 2002
OFFICE OF THE CLERK

No. 02-424

In The

Supreme Court Of The United States

Patricia Snowden,

Petitioner,

and

Karen Dowhite, Sheila Diane Dowhite, Lilistyne Dowhite, Renee Wingo Roberts, and Michael Smith, Sr.

Plaintiffs,

v.

CheckPoint Check Cashing and Elite Financial Services, Incorporated

Respondents,

and

Unknown Other Persons and Entities,

Defendants

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

PETITIONER'S REPLY TO BRIEF IN OPPOSITION

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ARGUMENT

As explained in the petition for *certiorari*, the Fourth Circuit's decision below holding that Patricia Snowden must arbitrate her claims against Checkpoint Check Cashing and Elite Financial Services ("Checkpoint") before there has been any determination that the parties entered into a legal and enforceable agreement squarely conflicts with holdings of at least three state courts of last resort and adds to the confusion among federal and state courts over the scope of this Court's holding in *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967). Because the ruling below misapplies the Federal Arbitration Act, 9 U.S.C. §§ 1 *et seq.* (FAA), by enforcing an arbitration clause in the face of Snowden's allegations that Checkpoint lacked signatory authority to enter into the underlying contract and that illegal terms rendered the entire contract void *ab initio*, the Court should grant the petition for *certiorari* and reverse the lower court's ruling.

I. The Split of Authority on Whether the FAA Authorizes a Court or an Arbitrator to Decide if an Entire Contract is Void For Want of Signatory Authority or Due to Illegal Terms is Substantial.

A. Checkpoint Fails to Distinguish the State Court Cases Conflicting With the Decision Below.

Checkpoint's main theme in opposition is that the authority conflicting with the decision below either is not important enough to warrant the Court's review or is somehow distinguishable. These arguments have no merit. The distinctions Checkpoint attempts to draw among the various federal and state court rulings on the question presented are either inaccurate or irrelevant. Furthermore, recent decisions have only served to broaden this conflict over the proper allocation of authority between courts and arbitrators under the

FAA where there are allegations that a contract containing an arbitration clause is void *ab initio*, never came into being, and therefore never gave rise to an agreement to arbitrate.

Checkpoint concedes, as it must, that the decision below and other recent circuit court rulings squarely conflict with the holding in *Alabama Catalog Sales v. Harris*, 794 So.2d 312 (Ala. 2000), that a court must resolve allegations that a payday loan contract is illegal and void under applicable state law before it can enforce the contract's arbitration clause under the FAA. In arguing that *Alabama Catalog Sales* involves the "misapplication of a properly stated ruled of law," (Opp. at 9) (quoting S. Ct. R. 10), and is an "outlier" decision, Checkpoint ignores both the substantial difference in the various courts' interpretations of the FAA and the precedential significance of decisions on both sides of this split.

The main problem with Checkpoint's characterization of *Alabama Catalog Sales* is that it attempts to explain away a split of authority simply by assuming the correctness of one side of the split and the error of the other side. Checkpoint contends that *Alabama Catalog Sales* erroneously departed from federal circuit court decisions in holding that a court must resolve questions concerning the substantive legality of an underlying contract. (Opp. at 10). But absent any decision from this Court on the question presented, there is no basis for Checkpoint's claim that *Alabama Catalog Sales* misapplied the FAA while the court below did not. Although *Prima Paint* holds that under the FAA an arbitrator must resolve allegations of fraudulent inducement, which would allow for recision of a previously enforceable contract containing an arbitration clause, the Court has never addressed the separate question of who decides allegations that an underlying contract is void *ab initio*, never came into being, and therefore never gave rise to an agreement

to arbitrate. This question continues to generate divergent outcomes among federal and state courts of appeal.

A further problem with Checkpoint's characterization of *Alabama Catalog Sales* and conflicting circuit court authority is that it fails to support the ruling below on Snowden's allegations concerning Checkpoint's lack of signatory authority. Checkpoint argues that the circuit courts agree that courts must decide "questions of signatory power" and "questions of assent to the general contract," (Opp. at 10) before they can order arbitration under the FAA, but that *Alabama Catalog Sales* took this rule a step too far by holding that courts must decide questions concerning the underlying contract's legality. (Opp. at 10-11). Even if this assessment of the case law were accurate, Snowden makes *both* types of allegations in this case, arguing that Checkpoint's payday loan contract is void because its terms are illegal *and* because Checkpoint lacked the requisite signatory authority to enter into a consumer loan agreement under Maryland law. Therefore, under Checkpoint's own assessment of prevailing appellate authority, the decision below was erroneous and the Fourth Circuit should have held that a court must at least resolve Snowden's allegations that Checkpoint had no signatory authority to enter into the contract.

Checkpoint's contention that *Alabama Catalog Sales* is an "outlier" decision is also mistaken. The Alabama Supreme Court recently reaffirmed *Alabama Catalog Sales* in holding that a nursing home whose license to do business in the state had been revoked could not enforce an arbitration clause in its contract with patients because the entire contract was void under state law. *See Community Care of America of Ala., Inc. v. Davis*, ___So.2d___, 2002 WL 31045217 at *3 (Ala. Sept. 13, 2002). In *Community Care*, the court observed that it was undisputed that the state had previously revoked the nursing

home's license, noted that applicable state law rendered void all contracts entered into by unlicensed foreign corporations, and held that precedent had established the "unremarkable proposition that a 'foreign corporation [may] not compel arbitration pursuant to an arbitration clause in a contract [if] the entire contract [is] unenforceable and invalid as a result of the foreign corporation's failure to qualify to do business in Alabama." *Id.* (quoting *Alabama Catalog Sales*, 794 So.2d at 315). Therefore, notwithstanding Checkpoint's attempt to diminish the conflict of appellate authority on the question presented, the split persists even in the face of recent circuit court decisions supporting Checkpoint's arguments.

Nor is the Alabama Supreme Court an "outlier" court on the question presented. Checkpoint fails to distinguish cases from other state courts that conflict with the ruling below by the Fourth Circuit. For example, Checkpoint concedes that the recent holding of *Nature's 10 Jewelers v. Gunderson*, 648 N.W.2d 804 (S.D. 2002), "appear[s] inconsistent with federal authority" (Opp. at 9), because the court there held that an unlicensed business could not enforce an arbitration clause in a contract that was rendered void based on the unlicensed party's lack of signatory authority. Checkpoint then attempts to draw a distinction by claiming that the court in *Gunderson* did not make clear that it was applying the FAA. (Opp. at 9-10). But this is a non-starter because the court in *Gunderson* did not need to make clear that the FAA applied. First, as the dissenting opinion in the case emphasized, it was "uncontested that the Federal Arbitration Act is the controlling law." *Id.* at 809 (Konenkamp, J., dissenting). Furthermore the disputed contract in *Gunderson* involved an agreement to operate a jewelry store franchise. Since the FAA "signals an intent to exercise Congress' commerce power to the full," *Allied-Bruce Terminix Co's, Inc. v. Dobson*, 513 U.S. 265, 277 (1995), a

business franchise agreement like that in *Gunderson* must fall squarely within the scope of the FAA's application. *See, e.g., Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681 (1996) (applying FAA to fast food restaurant franchise agreement). The ruling in *Gunderson* therefore deepens the split of authority on whether the FAA requires a court or an arbitrator to resolve allegations that a contract containing an arbitration clause is void for want of a party's signatory authority.

Likewise, Checkpoint does not meaningfully distinguish the New Hampshire Supreme Court's holding in *Pittsfield Weaving Co. v. Grove Textiles, Inc.*, 430 A.2d 638 (1981), that a court applying the FAA must decide allegations that a contract containing an arbitration clause is unconscionable. Checkpoint asserts that "*Pittsfield* addressed the issue of unconscionability—not the question of whether allegations of a void *ab initio* contract must be heard by the arbitrator or judge." (Opp. at 9). But Checkpoint does not even attempt to explain why the FAA would ever treat these two types of allegations aimed at invalidating an entire contract containing an arbitration clause differently from one another. Both allegations have the effect of voiding the whole contract, *see Pittsfield*, 430 A.2d at 639, both would prevent any contract containing an arbitration clause from ever coming into existence, and both therefore would implicate "the making of the agreement for arbitration," 9 U.S.C. § 4, so as to require judicial resolution under the FAA. The New Hampshire Supreme Court's holding in *Pittsfield* therefore is squarely in conflict with the ruling below by the Fourth Circuit.

Checkpoint fails to reconcile the deep split of authority among the lower courts on the question presented. As Checkpoint emphasizes, at least two other federal circuits have held consistent with the decision below that allegations that a

contract containing an arbitration clause is void for want of signatory authority or due to illegal terms must be resolved through arbitration. (Opp. at 6-7). These decisions conflict with decisions of an equal number of state courts of last resort holding that the FAA requires courts to resolve these types of allegations because an argument voiding an entire contract necessarily implicates the making of any arbitration agreement contained therein. The Court should grant review to resolve the split of authority on this important question of federal law.

B. Recent Cases Highlight the Extent of Conflict Among the Federal and State Courts of Appeal Over the Question Presented.

In the short period since the Fourth Circuit issued its decision below, at least three distinct positions have surfaced in state and federal appellate rulings on whether the FAA requires a court or an arbitrator to resolve allegations that a contract containing an arbitration clause is void *ab initio*. While courts embracing all three positions recognize *Prima Paint*'s holding that an arbitrator must resolve allegations of fraudulent inducement that would render a previously valid contract voidable, these courts are in sharp disagreement with one another over where to draw the line between *Prima Paint* and the command of Section Four of the FAA that courts resolve allegations related to the making of the arbitration agreement.

As described herein, the Alabama Supreme Court recently reaffirmed its earlier holding that the FAA requires judicial resolution of all allegations that a contract containing an arbitration clause is void *ab initio*. *See Community Care*, ___So.2d___, 2002 WL 31045217 at *3 (reaffirming *Alabama Catalog Sales*). This holding that courts always must resolve allegations implicating the existence of a contract is consistent

with the reasoning of the Third Circuit's opinion in *Sandvik AB v. Advent Int'l Corp.*, 220 F.3d 99 (2000). While Checkpoint is correct that *Sandvik* involved allegations that a party lacked signatory authority, not allegations that a contract's terms were illegal, the Third Circuit held that *Prima Paint* only applies to allegations that a contract is voidable and that allegations that a contract is void must be decided by a court. *Id.* at 107. These courts view *any* allegation concerning the existence of the underlying contract as necessarily implicating the making of the arbitration agreement under Section Four of the FAA.

As was explained in the petition for *certiorari* and in Checkpoint's brief in opposition, the Fourth Circuit below and at least two other circuits have taken a different position in holding that *Prima Paint* requires parties to arbitrate not only allegations that a contract is voidable, but also any allegation that a contract is void *except* where such allegations are based on a party's lack of assent to the underlying contract. *See* Pet. App. 10; *Burden v. Check Into Cash of Ky., LLC*, 267 F.3d 483, 490 (6th Cir. 2001), *cert. denied*, 122 S. Ct. 1436 (2002); *Bess v. Check Express*, 294 F.3d 1298, 1305-06 (11th Cir. 2002). These courts view *only* allegations relating to a party's assent to the underlying contract, but no other allegations aimed at the entire contract, as implicating the existence of an arbitration agreement under Section Four of the FAA.

Finally, a recent Fifth Circuit decision cited by Checkpoint (Opp. at 7) embraces a different position from all of those described herein. In *Primerica Life Ins. Co. v. Brown*, 304 F.3d 469 (5th Cir. 2002), the court held that *Prima Paint* applies to require arbitration of *all* allegations related to an underlying contract, *including* allegations that a contract is void for want of a party's assent. The court in *Primerica* ordered a party who was conclusively determined to have been "profoundly retarded

since birth," *id.* at 472 (Dennis, J., concurring), to arbitrate his claim that he lacked the capacity to contract under applicable state law. When faced with the argument that *Prima Paint* only requires arbitration of allegations that would render a contract voidable, but not those that would render a contract void or non-existent, the Fifth Circuit rejected the distinction altogether and held that all defenses or challenges to the existence of an underlying contract must be sent to arbitration under the FAA and *Prima Paint*. *Id.* at 471-72. In the Fifth Circuit's view, *no* allegations relating to the underlying contract as a whole, not even allegations that a party lacked the capacity or authority to enter into a contract, can ever implicate the making of the arbitration agreement under Section Four of the FAA.

In light of these conflicting interpretations of the FAA and *Prima Paint*, the Court should grant the petition for *certiorari* to resolve the split over this important question of federal law.

II. The Fourth Circuit's Decision Below is Inconsistent with the FAA's Policy of Placing Arbitration Agreements on the Same Footing as Other Contracts.

In answer to the argument that the decision below conflicts with this Court's holdings that the FAA places arbitration agreements on the same footing as other contracts, Checkpoint contends that *Prima Paint* resolves the question presented conclusively and that this Court's more recent decisions "have no bearing" on this case. (Opp. at 12-13). While this position is consistent with the Fourth Circuit's ruling below, it ignores how Snowden's allegations concerning Checkpoint's payday loan contract differ from those at issue in *Prima Paint* and make this case more like what the Court recently addressed in *Equal Employment Opportunity Comm'n v. Waffle House, Inc.*, 534 U.S. 279 (2002).

Snowden alleges that there was never an enforceable contract between herself and Checkpoint because Checkpoint was not licensed to make consumer loans in Maryland and because Checkpoint's usurious interest rates rendered any loan agreement void under state law.[1] Unlike the allegations of fraudulent inducement in *Prima Paint*, which would render a previously enforceable contract voidable or revocable,[2] Snowden's allegations would render any agreement between the parties void *ab initio* and therefore raise the question of whether the parties ever entered into an agreement to arbitrate claims.

Checkpoint's argument and the Fourth Circuit's holding below that Snowden's claims are subject to arbitration under the FAA parallel an earlier Fourth Circuit ruling that this Court overturned in *Waffle House*. There, the Fourth Circuit had held that the EEOC's claims brought on behalf of an individual were subject to arbitration under an agreement to which the EEOC was not even a party based on the court's evaluation of the FAA's policy favoring arbitration. *Waffle House*, 534 U.S. at 290. This Court reversed and held that the FAA's policy goals did not support arbitration of the EEOC's claims because the Act requires courts "to place arbitration agreements on equal footing with other contracts, but it 'does not require parties to arbitrate when they have not agreed to do so.'" *Id.* at 293 (quoting *Volt Info. Sciences, Inc. v. Bd. of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 478 (1989)). The same result should apply here because Snowden's allegations call

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[1] *See* MD. CODE ANN., FIN. INST. § 11-204(a)(1) (requiring license to make consumer loans); MD. CODE ANN., COM. LAW § 12-314(b)(1) (loans with interest in excess of statutory limit are unenforceable).

[2] *See Burden v. Check Into Cash*, 267 F.3d at 489 (citing *W.T. Langley v. FDIC*, 484 U.S. 86, 93-94 (1987)).

into question whether the parties ever entered into an agreement to arbitrate.

The Court should grant the petition for *certiorari*, reverse the judgment below, and hold that the FAA requires courts to resolve allegations that a contract containing an arbitration clause is void *ab initio* and therefore never came into being.

CONCLUSION

The petition for a writ of *certiorari* should be granted.

Respectfully submitted,

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